The paper presents a theoretical model of the imperfectly competitive market for loans in a developing country. In the model, loan default rates are affected by variation in the level of contract enforcement (measured by quality of governance indicators) and by variation in the level of market segmentation (measured by the level of ethnic fractionalisation in the country). The model predicts that the marginal effect of a change in fractionalisation or in institutions will be greater in countries with strong institutions and high fractionalisation, and in countries with weak institutions and low fractionalisation. Correspondingly, marginal changes in either fractionalisation or governance will have little effect in “fortunate” countries (strong institutions, low fractionalisation) and “unfortunate” countries (weak institutions, high fractionalisation). Panel data from 110 banks in 28 African countries is used to fit a model of loan default, and provides empirical support for these theoretical predictions.

The model complements and builds upon existing literature, particularly Andrianova et al (2015), by adding a nuanced discussion of the interaction effects between institutional quality and fractionalisation in determining the loan default rate in the economy. As such, the paper constitutes a contribution to the literature on loan default in developing countries, with a specific focus on market segmentation via ethnic fractionalisation in the context of African countries.

The authors have responded positively to all comments raised by the first referee and me by incorporating a number of changes in some cases, and by explaining their reasoning in others. In particular, the authors have improved the discussion of these results and stated their claims more carefully. While I continue to question the importance and value of the policy implications in this particular paper, I appreciate that the authors have limited the claims they have made with respect to them.